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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 727

FRANK J. LORENZ,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Sixth Circuit
and
BRIEF IN SUPPORT THEREOF

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LESLIE WEAVER PUBLISHERS, CINCINNATI, OHIO

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Frank J. Lorenz, petitioner above, respectfully petitions your Honorable Court that a writ of certiorari issue to review the decision and order of the United States Circuit Court of Appeals for the Sixth Circuit, entered April 13, 1945, petition for rehearing denied October 15, 1945, affirming a decision of the Tax Court of the United States entered May 8, 1944, in favor of the respondent and against the petitioner.

OPINIONS BELOW

The instant case originated with the filing of a petition (Record 3 and Record 14) for a rehearing on a deficiency found by the Commissioner of Internal Revenue (R. 6) in the Tax Court of the United States, which Court entered its decision on May 8, 1944 (R. 35). Printed

Record Pages 22 to 32 and reported in 3 T. C. 746, affirming the action of the Commissioner, and holding that "the petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all of the economic incidents of ownership." (R. 32). Five judges dissenting. (R. 33).

A petition for review from the decision of the Tax Court was filed in the United States Circuit Court of Appeals for the Sixth Circuit (R. 36) which Court affirmed the decision of the Tax Court without a written opinion (R. 219).

JURISDICTION

The decision of the Circuit Court of Appeals for the Sixth Circuit was entered on April 13, 1945 (R. 219). A petition for rehearing was filed May 3, 1945, rehearing was denied by the Court on October 15, 1945 (R. 233). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (Sec. 347 of Title 28 U. S. C. A.).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations here involved may be found in the Appendix, infra, pages 11 to 12.

QUESTIONS PRESENTED

This case involves the interpretation of the Internal Revenue Laws in connection with a husband and wife partnership and in which the following questions are presented.

1. Is the partnership between taxpayer petitioner herein and his wife one which should be recognized for federal income tax purposes?

2. Is the state and local law governing the ownership of property and the right to income therefrom to apply in the interpretation and application of the federal revenue laws?

3. Can the Tax Court of the United States, through a decision based upon its conclusions of fact, attribute income from property to the petitioner, the ownership of which has been previously decided and determined to be the property and income of another by a contested declaratory judgment action in an Ohio State Court of Record, the State Court having jurisdiction and having previously determined the status of the parties, the ownership of the property, and the right to income from said property?

4. Did the United States Circuit Court of Appeals for the Sixth Circuit err in sustaining the Tax Court's decision herein in taxing the petitioner with the entire earnings of the partnership under Section 22 (a) of the Revenue Act of 1938 and under the Internal Revenue Code?

STATEMENT

The general facts in these proceedings are not in dispute. However, the decision of law based on the ultimate conclusions of facts as found by the Tax Court of the United States are not concurred in by the Petitioner.

On January 10, 1940, Frank J. Lorenz and Isabel M. Lorenz entered into and signed a written agreement of co-partnership, to be effective January 1, 1940, to operate the business of The Lorenz Equipment Company. (Exhibit 1, R. 201, R. 103 and R. 70.)

Prior to the entering into of the above agreement, the petitioner, Frank J. Lorenz, on January 1, 1940, by an outright gift, upon which a gift tax return was duly made and filed, (Exhibit 8, R. 100), gave to Isabel M. Lorenz,

his wife, a one-half interest in The Lorenz Equipment Company (R. 105, 106 and 139), which interest was valued at $20,000.00, thereby releasing all control over the subject matter of the gift and the income to be derived from the gift, the gift itself consisting of tangible assets. (R. 107, 108.)

The petitioner contributed to the partnership, as his share of the capital, the one-half interest which he had retained and Isabel M. Lorenz contributed, as her share of the partnership, the one-half interest which had been given to her by her husband. A capital account was set up on the books of that company reflecting such ownership (R. 73, 75, 76 and Exhibits 2, 3, 4, and 17.) The earnings of the partnership thereafter were allocated to the respective partners under the terms of the partnership agreement. The books of the partnership were kept accordingly and funds were withdrawn from the partnership for Isabel M. Lorenz, (Exhibits 3, and 4, R. 74, 75, 77, 82 and 88.)

The Lorenz Equipment Company was known to be operated as a partnership during the year 1940 by persons and companies having occasion to do business with it (R. 60, 63, 68, 71, 72, 122, 151 and 152.)

Credit was extended to The Lorenz Equipment Company in the year 1940 on the basis that said company was a partnership, consisting of two individuals, Isabel M. Lorenz and Frank J. Lorenz. (R. 124, 152 and Exhibit 12.)

Policies, investments and the management of the company were conducted by both the petitioner and Isabel M. Lorenz, his wife, during the year 1940, according to the terms of the written partnership agreement entered into between the parties. Isabel M. Lorenz spent about two

full days of each week throughout the year at the company's place of business. (R. 78, 159, 160, 185, 189, 191 and 192.)

Funds were withdrawn from The Lorenz Equipment Company for Isabel M. Lorenz during the year 1940, which funds represented her share of the earnings and the return on her investment in the company, and at the close of business for the year 1940, distribution was made on the books of the company to the credit of Isabel M. Lorenz in the amount of one-half of the assets, profits and earnings of the company. (R. 73, 74, 75, 77, 80, 82, 83, 188 and Exhibits 2, 3, 4, 5, 6, 7, 8 and 13.)

Findings of the Tax Court (R. 24), were that the partnership enterprise had gross assets used in the business of approximately $44,000.00 and that these assets for the most part consisted of tangible items such as equipment, parts and machinery. During the year in question there were eight employees of The Lorenz Equipment Company. Further, during 1940, the gross profit of the business was as follows: (R. 27) Profit on sales—$37,322.80; Commission on direct sales—$3,480.50; General Machinery Income—$13,647.09; Shop Income—$608.71. These facts are important in proving that the partnership employed a very substantial capital in the production of its income and that this case is distinguishable from a family partnership where the earnings result from the individual efforts of the husband. (Exhibit 13, R. 103, 130, 131, 132, 133 and 140.)

Isabel M. Lorenz, as a partner in The Lorenz Equipment Company, brought an action, as plaintiff, against Frank J. Lorenz, this petitioner as a contesting defendant, said case being known as No. 163,783 in the Common Pleas Court of Franklin County, Ohio, in which she

secured a declaratory judgment and a final order on March 16, 1943, which order reaffirmed her right to keep and control one-half of the assets, proceeds and earnings of The Lorenz Equipment Company. (R. 205 and 213.)

Notwithstanding the foregoing facts, the Tax Court concluded (R. 32), "that the petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all of the economic incidents of ownership thereof," citing *Francis E. Tower*, which case is now pending in this Court on writ of certiorari, number 317; and that, therefore, the "petitioner's wife did not make any actual contribution to the capital of the partnership."

The Circuit Court of Appeals for the Sixth Circuit sustained the above decision of the Tax Court, without opinion, although the same Circuit Court of Appeals held exactly opposite in the *Tower* case cited above.

REASONS FOR GRANTING THE WRIT

1. Aside from the importance of the question herein involved as affecting State Courts, and their power to construe and determine local issues, we submit that the decision of the Tax Court of the United States and the decision of the Circuit Court of Appeals for the Sixth Circuit, were clearly erroneous and not in accord with the applicable decisions of this Court which have announced and adhered to the principle that in the application of the Federal Revenue Act, State law controls in the determination of the nature of the legal interests which the taxpayer has in property, and the income sought to be reached by the Statute.

See *Poe* v. *Seaborn*, 282 U. S. 101; *Erie Railroad Com-*

pany v. *Tompkins*, 304 U. S. 67, at page 78; *Morgan* v. *Commissioner*, 309 U. S. 78, at page 82; *Helvering* v. *Stuart*, 317 U. S. 154, at page 161.

The decision of the Tax Court of the United States, which decision the Circuit Court of Appeals affirmed, states "it is concluded that the petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all the economic incidents of ownership thereof", and that "it follows that petitioner's wife did not make any actual contribution to the capital of the partnership."

The foregoing decision, which was subject to a strong dissent in the Tax Court, is based on a clear cut mistake of law in that the Tax Court and the Circuit Court of Appeals for the Sixth Circuit both failed to apply the law as announced by this Court in the above cited cases and, further, failed to apply the "Supreme Court's rule of distinction." (See Mertens Law of Federal Income Taxation, Vol. 10, Section 61.09 and 61.11.)

> "When the will of Congress depends upon a fact which can be interpreted only according to a state rule of property, as upon the question whether title was passed under state law, the state rule will govern."

In addition to the uncontradicted facts, the record shows that Isabel M. Lorenz exercised full control over her one-half interest in the partnership and that both the control and the right to control the assets of the company, and the decision as to who were the owners of the assets, all are questions of local law which had been previously decided by the Ohio State Court of Record. (See final order and entry R. 211 and 212.)

The above facts and the law cited fit squarely into the case of *Blair* v. *Commissioner*, 300 U. S. 5, where the Court held in the opinion

> "2d. The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois and his disposition of the property in that State was subject to its law."

2. The Circuit Court of Appeals in affirming the decision of the Tax Court of the United States has decided an important question of federal law in direct conflict with the established principles announced by this Court, that the existence of a relationship or of a legal interest in property as established by local law and by common law rules of property must be recognized in the application of the Federal Revenue Act. In so doing it has departed from the principles laid down by this Court in *Dobson* v. *Commissioner*, 320 U. S. 489 and *Trust U/W of Bingham* v. *Commissioner*, decided June 4, 1945 to the effect that (a) "clear cut mistake of law made by the Tax Court requires its reversal."

The error of the Tax Court of the United States and the error of the Circuit Court of Appeals lies in their failure to distinguish between (1) those cases where taxpayers undertake to allocate or assign income to a person who does not produce that income, and (2) those cases where, according to a state rule of property, a legal interest has been created in favor of a taxpayer who has the right to enjoy the property or the legal interest therein and the income from said property.

3. The decision of the United States Circuit Court of Appeals for the Sixth Circuit is in direct conflict with the decision of the same Court in the case of *Commissioner of Internal Revenue* v. *Francis E. Tower*, 148 F. 2nd, 388,

which is now pending upon a writ of certiorari in this case, known as No. 317.

4. Family partnerships, especially those involving husband and wife, have been adopted by hundreds of taxpayers all over the United States. The aftermath of the formation of these partnerships has been a flood of litigation both before the Tax Court and before Federal Courts, which has resulted in the fact that the Commissioner of Internal Revenue, the taxpayers and their counsels have no definite rule from this Court pertaining to the questions raised.

There is now pending before this Court not only the Tower case cited above, but also the *Lusthaus Case No.* 263, both cases having been admitted on writ of certiorari. However, the instant case varies from the two aforementioned cases in that here we have not only the record but the fact that an Ohio State Court of Record has decided and decreed who were the owners of the property and who had the income from that property as a matter of local law.

It is important in the administration of the Revenue Acts, both to the Treasury Department and to the Taxpayers that the conflicts cited in the above cases, and discussed herein, should be clarified to the end that some degree of uniformity may be adopted by all concerned. This matter has been the subject of wide comment.*

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* American Bar Association Journal, "Family Partnerships," page 322, June, 1945.

Commerce Clearing House 1945 Rewrite Bulletin, No. 27, paragraph 8414, May 9, 1945.

Ibid., No. 28, paragraph 8420, June 27, 1945.

Estate and Tax News, Reprint of "That Family Partnership Quarrel," page 552, June, 1945 (material copyright Prentice Hall, Inc.)

George Washington Law Review, "The Partnership in Tax Avoidance," by Randolph Paul, page ....., February, 1945, condensed digest in Taxes, page 552, June, 1945.

Prentice Hall, Current Commentary Report, No. 23, paragraph 70526.

In the interest of brevity, petitioner does not at this time set forth all of the points which will be urged at the argument or the merits of this case should the writ be granted, nor all of the conditions in support of such points, but petitioner herein refers to and incorporates into this petition all of the matters presented in its assignment of errors contained in the supporting brief filed herewith, as if fully set out herein.

CONCLUSION

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out and under the seal of this honorable court directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding said Court to certify and send to this Court a full and complete transcription of the record and proceedings of the said United States Circuit Court of Appeals for the Sixth Circuit in Case No. 9871 and known as Frank J. Lorenz, petitioner, v. Commissioner of Internal Revenue, respondent, to the end that this case may be reviewed and determined by this Court as provided by the statutes of the United States; and that the decisions and judgment of said United States Circuit Court of Appeals for the Sixth Circuit be reviewed and reversed by this Honorable Court; and for the petitioner to have such further relief as to this Court may seem proper.

Respectfully submitted,

MARION A. ROSS,
Attorney for Petitioner.

December 28, 1945.

APPENDIX

Statutes Involved

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political sub-division thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (26 U. S. C. 1940 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. 1940 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in Section 183(b). (26 U. S. C. 1940 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise dis-

tinctly expressed or manifestly incompatible with the intent thereof—

• • • • •

(2) PARTNERSHIP AND PARTNER.—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization. (26 U. S. C. 1940 ed., Sec. 3797.)

IN THE

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

ORDERS OR JUDGMENTS OF THE COURTS BELOW

As heretofore stated, the United States Circuit Court of Appeals for the Sixth Circuit did not render a written opinion, but the order of the Court is found in Record 219, and the order of the Court on the petition for rehearing is found at R. 233. The decision of the Tax Court of the United States appears in the Record filed herewith at Pages 22 to 35.

JURISDICTION

The date of the decision and order of the United States Circuit Court of Appeals for the Sixth Circuit, to be reviewed is October 15, 1945, and this petition has been filed within the time provided by Statute. (R. 233).

The jurisdiction of this Court is invoked under Section 240 (a) of the judicial code, as amended by the Act of February 13, 1925. 43 Stat. 938 (Sec. 347 of Title 28, U. S. C. A.)

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations herein involved may be found in the Appendix, infra, at pages 11 to 12.

STATEMENT OF THE CASE

This has heretofore been stated in the preceding petition (Supra, pages 3 to 6), which is here adopted and made a part of this Brief as if fully rewritten herein. It is unnecessary to review the facts as the general facts are not in dispute. However, they are more fully set out in the statement of facts heretofore filed at Pages 3 to 6, and attention is called to the facts for the purpose of showing that the Tax Court erred in its decision which was not based on the record, nor did the same have "warrant in the record."

This case comes into this court on a petition for a writ of certiorari to review the decision and order of the Circuit Court of Appeals for the Sixth Circuit affirming a decision of the Tax Court of the United States. The Tax Court on petition for redetermination of a proposed deficiency assessed the entire income of The Lorenz Equipment Company, a mercantile establishment, to the petitioner on the theory that when the petitioner had given his wife a one-half interest in the business, he had not relinquished control of "all of the economic incidents of ownership thereof."

The petitioner in January of 1940 gave to his wife a one-half interest in his business, which was valued at $44,380.22.

SPECIFICATION OF ERROR

The Circuit Court of Appeals erred (1) in holding that the conclusions and the decision of the Tax Court of the United States were supported by substantial evidence.

(2) In failing to hold that the decision of the Tax Court was not in accordance with the law.

(3) In affirming the decision of the Tax Court.

ARGUMENT

Summary of Argument

The sole issue in this case is whether or not a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company was made by the petitioner herein to his wife, (See dissent Tax Court opinion R. 33 to 35), and whether or not the petitioner after the gift was made retained such control and domination over the subject matter of the gift to the point that no substantial change was made in the economic interests and the controls exercised by the petitioner.

The Tax Court, after determining the facts in the case, rendered its decision, which decision is not in accord with its findings of fact and the entire decision was based on the closing statement of the Tax Court in its opinion (R. 32) wherein the Court stated:

> "The facts here do not show that petitioner's wife exercised any control over the subject matter of petitioner's alleged gift to her ***.
>
> It is concluded that petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all of the economic incidents of ownership thereof. Francis E. Tower, 3 T. C., No. 49. Under all of the facts, the various bookkeeping entries are not controlling. Sitterding v. Commissioner, 80

> Fed. (2d) 939. It follows that petitioner's wife did not make any actual contribution to the capital of the partnership."

From a reading of the foregoing, one would gather that the wife of the petitioner did not receive a gift in accordance with the principles as laid down for a bona fide gift in the case of *Edson* v. *Lucas*, 40 Fed. 2nd, 398. However, an entire search of the record in the instant case will not disclose an instance in which the recipient of the gift, the wife of the petitioner herein, failed to exercise complete domination and control over the gift which she received. There are no facts in the record to justify the Tax Court's conclusion set forth above. There is nothing in the evidence to justify the conclusion or finding that the petitioner's wife did not acquire a separate interest of her own in The Lorenz Equipment Company, and there is nothing in the evidence or in the record but what shows that the petitioner's economic interest in the equipment business was very definitely reduced after the above gift was completed.

The Tax Court's decision is not in accordance with law; its ultimate conclusion being a mistake of law and wholly unsupported by any substantial evidence in the record. The issues herein presented are not such that they come within the special competence of the Tax Court, but are such that they are subject to review on appeal, and the decision of the Circuit Court affirming the Tax Court should be reversed.

ARGUMENT

I

Did the Petitioner Exercise Good Faith in Forming a Bona Fide Partnership with His Wife?

Nowhere in the record did the Commissioner of Internal Revenue question the good faith or the intention of the petitioner in forming the partnership in question. Therefore, the bulk of our argument will be confined to the element of control of economic interests.

II

Did the Petitioner Make a Gift to His Wife Relinquishing Control of a One-Half Interest in the Lorenz Equipment Company?

The general facts in these proceedings are not in dispute. *The findings of fact of the Tax Court of the United States are as follows*: (R. 25) "In January of 1940, petitioner told his wife that he wanted to give her a gift of a 50% interest in the tangible assets of The Lorenz Equipment Company. *** Petitioner filed a gift tax return, reporting that he made a gift in January, 1940, of an interest in The Lorenz Equipment Company to the value of $20,000.00 at the date of the gift." "On January 10, 1940 articles of co-partnership between petitioner and his wife were executed by them. The agreement recited that the petitioner and his wife owned a one-half interest each in the assets of the business and that they contributed all of said interest to the capital of said partnership."

The entire partnership agreement can be found in R. 201, and in discussing that agreement the Tax Court found in its findings of fact (R. 26), "*** that either party could make contracts on behalf of the partnership business and could employ and discharge employes; that profits and

losses should be shared equally between the partners." The Tax Court further found in its findings of fact (R. 26) that "petitioner orally informed a bank and several others that his wife was a partner in the business;" and, further "after the partnership agreement was executed, and as of January 1, 1940, a capital account was opened in the name of Isabel M. Lorenz and entries were made debiting petitioner's account $20,000.00 and crediting his wife's account $20,000.00." And further, the Tax Court in its findings of fact found (R. 26), that "the net profit of the business for the year 1940 was—$24,506.04 at the end of 1940, that the capital account of petitioner was credited $12,253.02 profit for 1940; and the capital account of petitioner's wife was credited $12,253.02, profit for 1940." Further, the Tax Court in its findings of fact found (R. 27) that "one-half of the net profit for 1940 was reported by petitioner and one-half by his wife in their separate income tax returns for 1940." The Tax Court further found in its findings of fact (R. 27), that "during 1940 there were eight employees in The Lorenz Equipment Company, three salesmen, three servicemen and two office employees. A copy of the financial statement of The Lorenz Equipment Company can be found in the Tax Court's findings of fact (R. 24), which definitely shows that the business was of a mercantile character and that the profits from that business were largely dependent upon invested capital and that the Tax Court in its findings of fact pointed this out (R. 27); that "during 1940 the gross profit of the business was $55,059.10 which was derived as follows: Profit on Sales—$37,322.80, Commission on Direct Sales—$3,480.50, Rental Machinery Income—$13,647.09, Shop Income—$608.71.

We recite the above findings of fact made by the Tax

Court in detail because they evidence the very essence of control on the part of the recipient of the petitioner's gift. They are an indication in themselves that the petitioner lost control over one-half of the investment of The Lorenz Equipment Company.

It is permissible in Ohio to have a husband and wife partnership. (See Ohio General Code, Section 799, which states:

> "A husband and wife may enter into any engagement or transaction with the other, or with any other person, which either might if unmarried; subject, in transactions between themselves, to the general rules which control the actions of persons occupying confidential relations with each other."

The law in Ohio permitting the formation of a husband and wife partnership, the instant partnership therefore was formed, and during the year 1940 The Lorenz Equipment Company was known to be operated as a partnership by persons and companies having occasion to do business with it, (R. 60, 63, 68, 72, 81, 122, 151 and 152), all of which record covered the testimony of witnesses who dealt with the partnership, who extended credit to the partnership, who performed services for the partnership.

III

Local Law Controls in Determining the Status or a Relationship Made Expressly Subject to Federal Taxation.

We have heretofore pointed out that Ohio law permitted the formation of this partnership; that the interests secured by the petitioner's wife through the gift from her husband was accepted by her; that she used the gift; that she exercised control over it; and that she received cash benefits and income from the partnership; that in

all two separate economic interests were established by the gift and the formation of the partnership. All of these things are reiterated, reaffirmed and secured to her by the declaratory judgment action rendered in the Ohio State Court of Record, being known as an action in the Common Pleas Court of Franklin County, Ohio, wherein Isabel M. Lorenz, plaintiff, against Frank J. Lorenz, a contesting defendant, and known as Case No. 163,783. The record and testimony shows that at the time the above action for a declaratory judgment was sought by Isabel M. Lorenz, her husband and partner in the business had threatened to sell part of the assets of the business and that it was necessary for her to enjoin him from so doing. (See R. 205-210.) As a result of the action a final entry and order was made in the above case, being put on record prior to any hearing in the Tax Court. (See R. 211-212.)

This case is entirely different as a matter of law than any of the tax cases that are before this Court in that the Court will notice after reviewing the above pleadings (see R. 205-212), that Mr. Lorenz made a general denial to the allegations of the petition filed by his wife in the declaratory judgment action and in that general denial he denied the very existence of a partnership.

It is our contention that the Ohio Court after determining the owners of The Lorenz Equipment Company and the respective interests of the partners, their status and relation to each other, that the Federal Income Tax Law Sections 181 and 182 cited supra should be applied accordingly, and that the incomes of the respective partners should be taxed as their individual incomes.

This Court said in *Poe* v. *Seaborn*, 282 U. S. 101-110, as follows:

> "What then is the law of Washington as to the ownership of community property and of community income including the earnings of the husband's and wife's labor? The answer is found in the statutes of the State and the decisions interpreting them."

Then again, this court said in *Blair* v. *Commissioner*, 300 U. S. 5, 9, specifically speaking as to the validity of an assignment:

> "The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois, and his disposition of the property in that State was subject to its law. By that law, the character of the trust, the nature and extent of the interest of the beneficiary, and the power of the beneficiary to assign the interest in whole or in part, are to be determined. The decision of the state court upon these questions is final."

See also *Helvering* v. *Fuller*, 310 U. S. 69, 74; *Morgan* v. *Commissioner*, 309 U. S. 78, 82, and the case of *Helvering* v. *Stuart*, 317 U. S. 154, 161 where Mr. Justice Reed says:

> "When Congress fixes a tax on the possibility of * * * the distribution of income, the 'necessary implication,' we think, is that the possibility is to be determined by the state law. * * * Congress has selected an event * * * and has directed a tax to be levied if that event may occur. Whether that event may or may not occur, depends upon the interpretation placed upon the terms of the instrument by state law. *Once rights are obtained by local law, whatever they may be called, these rights are subject to the Federal definition of taxability.*"

This case should not be placed in the category with cases where husbands attempt to assign their income from occupations such as engineering, practice of medicine, or law, the selling of real estate or insurance, in all of which cases the income can only be determined by the

husband. All of the facts as shown in our statement of facts in the petition for a writ of certiorari are the common every-day occurrences which go into the operation and the carrying on of a partnership enterprise wherein invested capital is required, and we state that the factual inferences and the conclusions drawn by the Tax Court do not have a substantial basis in the evidence or in the record of this case, and we rely upon the principles set forth in *Commissioner* v. *Scottish American Company*, 323 U. S. 119, 124, where Mr. Justice Murphy speaking for a unanimous court said:

> "When the Tax Court's factual inferences and conclusions are determinative of compliance with statutory requirements, the appellant courts are limited to a determination of whether they have any substantial basis in the evidence. * * * If a substantial basis is lacking, the appellant court may then indulge in making its own inferences and conclusions, or it may remand the case to the Tax Court for further appropriate proceeding."

We have attempted to set out in chronological order exactly what the petitioner and his wife did (see our statement of facts and supporting references to the Record.) It is impossible for petitioner to understand what further the partners, or the petitioner, could or should have done to more completely evidence the sincerity of his purpose, which was to create and to conduct a business partnership and to give his wife a one-half interest in the business, the tangible assets of which he had worked years to acquire, and we would point out that he was not giving income, but he was giving the assets which were the instruments which would produce the income to be made by the partnership in the future. The Petitioner had no guarantee of the future. When he made the gift he knew not

what the income of the partnership might be for 1940. He showed his good faith by having his bookkeeper show on the books at the start of the year that his wife and partner would be entitled to 50% of the income to be made.

We urge that this case falls squarely in line with *Blair* v. *Commissioner, supra,* and the cases cited before, and whether or not the gift was completed in this case was a matter which should have been left to and was determined by local law.

IV

The Tax Court's Decision "Is Not in Accordance with Law" and the Decision of the Circuit Court of Appeals Affirming it Should be Reversed.

Petitioner herein is not disputing the facts as found by the Tax Court to the extent that its findings are factual. It is the legal effect given to the legal conclusions based on admitted facts which is the issue here. The whole reasoning of the Tax Court is grounded upon a basic mistake of law, raised on a false foundation, and the Court below was guilty of reversible error in accepting the erroneous legal conclusion of the Tax Court and in affirming that Court's decision without substantial supporting evidence in the Record. In *Dobson* v. *Commissioner,* 320 U. S. 49, and in *Bingham* v. *Commissioner,* ..... U. S. ..... 89, L. Ed. Advance Opinions 1191, Mr. Justice Frankfurter said at Page 12:

> "The interpretation of tax statutes and their application to particular circumstances are all matters peculiarly within the competence of the Tax Court. On the other hand, constitutional adjudication, *determination of local law questions and common law rules of property, such as the meaning of a 'general power of appointment' or the application of the rules against perpetuities, are outside the special province*

of the Tax Court. See Paul, Dobson v. Commissioner; the Strange Ways of Law and Fact (1944) 57 Harv. L. Rev. 753, 847-8. (Italics supplied.)

The reasoning of the Tax Court's decision shows that the factor influencing the Court was the legally erroneous conception that the gift in this case was not complete. This is a mistake of law.

CONCLUSION

There is no question of assignment of income in this case, nor does the rendition of personal services to the partnership enter into this matter, but rather this case is dependent entirely upon the question did the individual partners contribute to the partnership capital from which income was derived? This is in substance a question of who were the owners of the assets of the company. The Ohio State Court said Mrs. Lorenz was a partner. The Tax Court itself even found that the petitioner made a gift, but in the closing of its opinion the Court concluded that the donee did not take control of the gift. However, there is no basis in the evidence for such a conclusion. The issue raised here is one squarely on the point—what did the local law say as to who were the owners of the partnership assets, and who were entitled to its income, and who should exercise control over such assets? Regardless of the acts of either one of the partners, it is our contention that the Tax Court of the United States should have taken the petitioner and his wife as the Tax Court found them and their status to be under the local law, and then to apply the Federal Income Tax Law accordingly. The question decided by the Tax Court was not one which was peculiarly within the competence of the Tax Court to resolve. The Tax Court's conclusion is not "allowable";

its decision is not in accordance with law and the decision of the Circuit Court affirming the Tax Court's decision without opinion should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 727

FRANK J. LORENZ, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 22–32) are reported at 3 T. C. 746. The *per curiam* opinion of the Circuit Court of Appeals (R. 219) is reported at 148 F. 2d 527.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 13, 1945 (R. 219), and a petition for rehearing was denied on October 15, 1945 (R. 233). The petition for a writ of certiorari was filed on January 8, 1945. The juris-

diction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTION PRESENTED

Whether the court below erred in affirming the decision of the Tax Court that the taxpayer's wife was not a partner with him for purposes of determining his liability for income tax, and that the income attributed to his wife by a partnership agreement was includible in his gross income as defined by Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATION INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> (26 U. S. C. 22.)

* * * * *

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 181.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *

STATEMENT

The facts found by the Tax Court (R. 22–28) may be stated as follows:

From 1927 until 1933, the taxpayer was employed as bookkeeper, stenographer, and finally as a salesman, by the Consolidated Equipment Company in Cincinnati, Ohio. He sold industrial machinery, such as concrete mixers, air compressors, steam shovels, hoists and pumps, to contractors, public utility companies, and business concerns. After Consolidated became bankrupt in 1933, the taxpayer started in business for himself as an authorized distributor for manufacturers of

such machinery. He sold on commission to customers from catalogues, and the manufacturers made deliveries directly to the purchasers. The business was conducted as a sole proprietorship under the name of Lorenz Equipment Company. (R. 23.)

At some time during the year 1937, the business was incorporated by the taxpayer and one Wheeler, under the name of Lorenz-Wheeler Corporation, with each owning 50 percent of the stock. The taxpayer's wife did not receive any stock or any interest in the business. In the early part of 1939, Wheeler withdrew from the business and the corporation was dissolved. Thereafter, the business was again conducted by the taxpayer in sole proprietorship. (R. 23–24.)

As of December 31, 1939, the balance sheet of the business showed cash, accounts receivable, and similar current assets, totalling about $19,000; merchandise inventory and machinery held for rental, worth nearly $24,000; furniture and a truck, worth nearly $1,500; and total liabilities of $7,724.12. (R. 24–25.)

The taxpayer had married in 1927, two years after his bride graduated from high school at the age of seventeen. At the time of the hearing in the Tax Court, they had six children, ranging in age from four to fifteen years. Before her marriage, the taxpayer's wife had had some experience in office work such as filing, typing, simple bookkeeping, and attending to the cash

register. Before 1940, the tax year involved, she had rendered no services in her husband's business. From the time of her marriage, and through 1940, her household duties had occupied substantially all of her time. During 1940, she did most of the housework, cleaning and cooking, and hired someone to help her two days a week. (R. 22.)

At the beginning of 1940, the taxpayer's wife had a savings account in which there was a balance of $140. She did not own any securities and she had no other cash. The title to the home in which taxpayer and his wife live is held in both their names jointly, but at the beginning of 1940 the entire purchase price had not been paid. (R. 22–23.)

The wife knew "very little" about the "business end" of the taxpayer's affairs. She went to the office two days a week, on her "days off" from her household duties, and sat with the bookkeeper. Her knowledge of bookkeeping was insufficient for her to keep the books. She was interested in learning how to make entries in the books and do bookkeeping, and the bookkeeper permitted her to total columns of figures. She also took phone calls at home relating to the business which came in after office hours and reported them later to the taxpayer, or to someone at the office. (R. 23.)

In January of 1940, the taxpayer told his wife that he wanted to give her a gift of a fifty percent

interest in the tangible assets of the Lorenz Equipment Company. The audit of the books for the year 1939 had not been completed, and the taxpayer estimated the value of the 50 percent interest which he desired to give his wife, at $20,000. There was no written instrument of gift or assignment of an interest in the business. The taxpayer filed a gift tax return reporting that he had made a gift in January, 1940, of an interest in the Lorenz Equipment Company having a value of $20,000 at the date of gift. Until the alleged gift of an interest in the business was made, the wife did not own any interest in the business nor did the taxpayer consider that she did. (R. 25.)

On January 10, 1940, articles of copartnership were executed between the taxpayer and his wife. The agreement recited that each owned a one-half interest in the assets of the business, and that they contributed all of such interests to the capital of the partnership. It also recited that the business would be carried on under the name of "The Lorenz Equipment Company", as a partnership, effective as of January 1, 1940; that the taxpayer would devote his entire time to the business and that the wife would be required to devote only her available time to the business; that either party could make contracts on behalf of the partnership business and could employ and discharge employees; that profits and losses should be shared equally between the partners; that com-

plete books of account should be kept, but that the keeping of the books should be under the supervision of the taxpayer; that the taxpayer should have charge of all of the finances of the business; that the taxpayer should have a drawing account and that the drawing account should be charged to the capital account of each partner, equally; that profits should be divided at the end of each year; and that upon a termination of the partnership, the assets should be appraised and the partnership dissolved in accordance with law. (R. 25–26.)

The partnership agreement was not filed in any public office. The taxpayer orally informed a bank and several others that his wife was a partner in the business. (R. 26.)

Capital accounts were set up on the books of the company showing that the taxpayer and his wife each had a $20,000 interest in the business. A drawing account was opened on the books in the name of the taxpayer, but no drawing account was opened in the name of the wife. (R. 26.)

During 1940, according to the books, the taxpayer withdrew cash in the total amount of $9,381.11. He was not paid any salary, as such, but withdrew from the business what he needed. The wife did not withdraw any sum. At the end of the year, however, the capital account of the wife was debited $4,690.55 with the explanation, "To charge money withdrawn in 1940"; and the

capital account of taxpayer was debited $4,690.56, with the same explanation. (R. 26.)

The net profit of the business for the year 1940 was $24,507.04, and at the end of the year the capital accounts of the taxpayer and his wife were each credited with half that amount. None of the profit was distributed to the wife, but each reported the amount so credited in a separate income tax return. (R. 26–27.)

The taxpayer's actual withdrawals from the business in 1940 totaled $9,358.46, and were made as follows (R. 27):

Attorney's fees	$425.00
Payment on note of petitioner for purchase of automobile	697.79
Repair to a driveway at home	96.00
Income tax	874.94
Premiums on life insurance, Isabel Lorenz beneficiary	3,379.73
Cash items	3,885.00

Out of the "cash items" totaling $3,885, the taxpayer gave his wife $720, and deposited the balance in his own checking account. He paid the current household bills with his personal checks, and gave his wife about $30 a week cash to cover household expenses, in addition to the $720. (R. 27.)

During 1940 there were eight persons employed in the Lorenz Equipment Company: three salesmen, three servicemen, and two office employees. The taxpayer has at all times been the general manager of the business and the principal salesman. During 1940 the gross profit of the busi-

ness was $55,059.10, which was derived as follows: profit on sales, $37,322.80; commission on direct sales, $3,480.50; rental machinery income, $13,647.09; shop income, $608.71. (R. 27.)

After the partnership arrangement was made, there was no change in the conduct of the business, and the taxpayer continued to operate the business in exactly the same way as before (R. 27).

The taxpayer has always discussed his business affairs with his wife, and she has always assisted him by taking telephone calls at home and keeping him advised of them. She has always been a thrifty help-meet in domestic affairs. The partnership arrangement resulted in no change in the wifely assistance which she gave him. (R. 27–28.)

In determining the deficiency, the Commissioner held that no bona fide partnership for income tax purposes existed between the taxpayer and his wife, and that consequently the entire distributable income of the Lorenz Equipment Company was taxable to him. The notice of deficiency was mailed on December 7, 1942. (R. 28.)

On February 20, 1943, the taxpayer's wife commenced an action in the Court of Common Pleas of Franklin County, Ohio, for a declaratory judgment that the partnership was bona fide and that in the taxable year she was entitled to share in one-half of the profits of the partnership. At

the trial of the action, the taxpayer did not deny that there was a bona fide partnership between himself and his wife, and the court thereupon entered judgment in favor of taxpayer's wife. In that action, there was no real controversy between taxpayer and his wife. (R. 28.)

On a petition filed by the taxpayer on March 2, 1943 (R. 28), the Tax Court sustained the Commissioner's determination on the ground that the taxpayer had not divested himself of "control over income" (R. 30); that he had not made a "bona fide gift of a one-half interest in the business"; and that the small amount of the profits received by the wife "came to her by virtue of the marital relationship" (R. 32). For the reasons stated in the opinion of the Tax Court, and citing only *Dobson* v. *Commissioner,* 320 U. S. 489, the court below affirmed the decision in a *per curiam* opinion (R. 219).

DISCUSSION

This Court has pending before it two cases involving the general income tax problems arising out of the so-called family partnership; in both, the Tax Court found, in effect, that the wife contributed neither consequential services nor independent capital, and that, viewed realistically, the enterprise continued to be under the sole control of the husband. *Lusthaus* v. *Commissioner,* No. 263, this term; *Commissioner* v. *Tower,* No. 317, this term.

There would not seem to be any reason for additional consideration of the issues in the present case.[1] But since the ultimate rulings by this Court in the *Lusthaus* and *Tower* cases may announce principles affecting the present case, the Court may wish to withhold immediate action upon the petition and dispose of it subsequently in the light of the decisions to be rendered in those cases.

Respectfully submitted.

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JANUARY 1946.

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[1] Compare the denials of certiorari in *Doll* v. *Commissioner*, No. 138, this term; and *Argo* v. *Commissioner*, No. 436, this term.

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